No. 8888.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

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In the Matter of

POMOC OIL COMPANY,

Debtor.

J. A. SASSO,

Appellant,

vs.

HERBERT C. GOLDMAN, as Trustee in Bankruptcy of Pomoc Oil Company, a corporation, Debtor,

Appellee.

APPELLANT'S REPLY BRIEF.

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Preliminary Statement.

A reading of appellee's brief would seem to indicate that counsel urges the court to accept three very novel propositions of law, viz.:

1. That after a state court has rendered a judgment, by default or otherwise, a bankruptcy court may set it

aside and enter another and different judgment of its own, instead of adopting the procedure that would have been required of creditors of the bankrupt, or the bankrupt itself, that of proceeding in the court wherein the judgment was rendered.

2. Where parties testified without contradiction concerning the loan of money, gave a promissory note therefor on which judgment was rendered, without the proof of any fraudulent conduct on the part of appellant, or the necessary elements of partnership or joint adventures being present, the court may subordinate appellant's claim to those of general creditors.

3. That the findings of the referee and district court based on questions of fact are conclusive.

Of course, respondent does not present the matter in exactly this form, but if this judgment is permitted to stand, such will be its identical effect.

Under Point I respondent argues that the judgment of the state court was not conclusive. It is a fundamental principle of law that, except for fraud, collusion and want of jurisdiction, the judgment of one court cannot be attacked in another. A number of leading authorities to that effect were cited in our opening brief which counsel for appellee ignored. Neither fraud, collusion nor want of jurisdiction were pled as an objection to

the claim, nor was any evidence introduced or finding made to that effect, nor has there been the slightest suggestion as to the existence of these necessary elements.

Assume that no judgment had been rendered in the state court and appellant had merely filed a claim with the bankrupt corporation's note attached, and the same evidence was introduced as in this hearing. What finding could the referee have made that would have been supported by such evidence? None other than that appellant loaned $2500 to George Marcell for which he received his note with the understanding that the money was to be used by the corporation and the corporation's note would later be given him, and that the money was actually used by the corporation, which executed and delivered to appellant its promissory note therefor; that George Marcell agreed to give appellant one-half of his interest in the corporation, and that no agreement was made by the corporation to give appellant any consideration other than to repay the sums borrowed in accordance with the terms of its promissory note.

ANALYSIS OF AUTHORITIES.

I.

Where There Is Absolutely No Evidence to Show That Appellant Had a Right to Joint Participation In the Management or Control of the Business of the Bankrupt, It Is Error to Find That a Partnership or Joint Adventure Existed.

Appellant will not burden the record by repeating authorities cited under paragraphs IV, V and VI of his opening brief. However, to stress the extent and analogy of the holding in *Treat v. Murdock,* 8 Cal. (2d) 316, 321, we call attention to the following excerpt:

> "Nor does the agreement of Murdock to pay appellants' note out of a percentage of the net proceeds of the mine *and to continue to pay them a share of those proceeds after the note was satisfied fix the relationship of partners.*"

It is submitted that the situation above and that in the case at issue are practically identical.

Appellee cites other earlier California cases to overcome the positive statements of appellant's authorities, but each of such cases are irrelevant. For instance, the most recent case cited by appellee, *Associated Piping etc. Ltd. v. Jones,* 17 Cal. App. (2d) 107, 113, does not touch upon the question of a partnership arising from the mere acceptance of an interest in the profits of a business. The entire decision is based on *estoppel.*

> "We are satisfied that the conduct of the appellant clearly brings him within the provisions of section 2410 of the Civil Code, defining a partner by estoppel."

Certainly it cannot be urged that appellant, in the case at issue, held himself out to anyone as a partner.

Harper v. Sloan, 177 Cal. 174, cited and quoted by appellee, involves a case where the persons charged as mining partners clearly purchased an interest in the property itself. After some reconstruction of the contract by the Court, it was held to read, at page 180, as follows:

> "'Whereas, Harper wishes to transfer to Sloan and Dwyer two-thirds of his interest in the contract (lease with option to purchase) between himself and McGregor and Lewis, Harper agrees that such two-thirds shall pass to and vest in Sloan and Dwyer, and Sloan and Dwyer agree that they will pay to Harper' the sums stated." (Parenthetical statement ours.)

In the case at issue the agreement clearly entitles appellant to share in the profits of the venture only; he has absolutely no interest in the property itself as represented by the lease. An examination of each of the remaining earlier decisions cited by appellee clearly shows the same situation which existed in the last discussed case of *Harper v. Sloan*.

Accordingly, if the parties in cases cited by appellee actually own a portion of the property itself, such ownership carries the right to joint control and management, and the situation is not analogous to that in the instant case. For instance, in *Nowell v. Oswald*, 96 Cal. App. 536, cited by appellee as analogous to the situation herein, the Court said:

> "Appellant had power under the arrangement through his agent to make contracts, incur liability, and manage the whole business."

Obviously, with those facts as a basis for the finding of partnership, the decision becomes irrelevant.

That the right to share in the profits does not carry with it an interest in the property itself, or a right to possession thereof, is well settled. Referring again to a case cited in our first brief, *Treat v. Murdock,* 8 Cal. (2d) 316, 320, the California Supreme Court, in reversing a decision based upon a finding of partnership, said:

> *"It has uniformly been held that ownership of the mine, or an interest in it or an option to purchase it or the right to possession of it is a prerequisite for the existence of such a partnership.* (Michalek v. New Almaden Co. Inc., 42 Cal. App. 736 (184 Pac. 56); Stuart v. Adams, 89 Cal. 367 (26 Pac. 970); Prince v. Lamb, 128 Cal. 120 (60 Pac. 689).) There is also the further requirement that the partners actually engage in working the mine. This does not mean that each of the partners must perform physical labor in the mine. But it does require that each of the partners have some part in carrying on the mining operations. 'The partnership arises only when the co-owners unite and co-operate in working the mine.' (Petersen v. Beggs, 26 Cal. App. 760 (148 Pac. 541).) Each of these elements of a mining partnership is entirely lacking in the record in the instant case. The appellants never acquired any interest whatever in the mining property and the uncontradicted evidence is that they never did any work on the property, they never directed any of the mining operations or had anything to do with the management of the mine."

Certainly, if it were necessary to reverse a finding of partnership in the case last cited, the same requirement is present herein.

II.

The Claim of Appellant Herein, if He Is Not a Partner or Joint-Adventurer With the Bankrupt, Cannot Be Subordinate or Junior in Rank to Claims of Other General Creditors Unless It Is Shown That Appellant Was Guilty of Conduct Which Would Make It Inequitable for Him to Share Equally With Other General Creditors.

In support of appellee's Point II, that appellant's claim is subordinate to those of general creditors, appellee first cites Remington on Bankruptcy, section 2875, the material portion of which reads as follows:

> "Under the power of the court to adjust the equities existing among general creditors, it has been held that the claims of creditors who, though not guilty of preferences voidable under the peculiar provisions of the Bankruptcy Act, have yet been guilty of conduct which, under the ordinary rules of equity, would make it inequitable for them to share in the dividends on an equality with other creditors, may be postponed to the claims of other creditors in the distribution of dividends."

It is at once apparent that before this rule of law can be applicable the trial court must have made a finding, based upon evidence that would sustain it, of course, that the claimant had "been guilty of conduct which, under the ordinary rules of equity, would make it inequitable" for him to share in the dividends on an equality with other creditors. There is no evidence of any fraudulent or unfair conduct on appellant's part which would make him subject to this rule.

Only one of the decisions upon which Prof. Remington bases this text contains any statement of what constitutes inequitable conduct. That case, *Crowder v. Allen West Co.*, 213 Fed. 177, 184, also involves a situation where the claim of a creditor was sought to be subordinated because of inequitable conduct. The Court said:

> "The equitable principle upon which it is sought to exclude it is that 'He who has done iniquity shall not have equity.' But in what way has the company done iniquity? Counsel for the trustee answer, by deceiving the other creditors into the belief that Hawks was solvent and thereby inducing them to give him credit to their damage. But an intent to deceive one to his injury, or knowledge of the falsity of the misrepresentation, or a reckless misrepresentation made in ignorance of the fact is indispensable to actionable deceit or fraud. Union Pacific Ry. Co. v. Barnes, 64 Fed. 80, 83, 12 C. C. A. 48, 51; Western Union Telegraph Co. v. Schriver, 141 Fed. 538, 541, 72 C. C. A. 596, 599; Kahl v. Love, 37 N. J. Law 5, 6, 7; Polhill v. Walter, 3 Barn. & Adolph 114, 124. *A creditor must have been guilty of some moral turpitude or some breach of duty by which other creditors were deceived to their damage to constitute such a fraud as will estop him from sharing with them in the distribution of the proceeds of the estate of his debtor in bankruptcy.* A wilful intent to deceive or such gross negligence as is tantamount thereto is an essential element of such an estoppel. Henshaw v. Bissell, 18 Wall. 255, 271; New York Life Ins. Co. v. McMaster, 87 Fed. 63, 67, 30 C. C. A. 532, 536; Daniels v. Benedict, 97 Fed. 367, 380, 38 C. C. A. 592, 605; Farmers & Merchants Bank v. Farwell, 58 Fed. 633, 639, 7 C. C. A. 391, 397."

The foregoing quotation was cited with approval in a similar and more recent case, *Bird & Sons Sales Corp. v. Tobin,* 78 Fed. (2d) 371, 374, C. C. A. 8th.

Concerning authorities cited by appellee on the proposition under consideration, it is clear that they are not applicable.

The most recent case cited and quoted, *Bank of America National Trust & Savings Assn. v. Fisher,* 61 Fed. (2d) 53, 55, involves a situation where the parties stated in their contract that they were joint adventurers, and admitted facts showing such relationship in their briefs. The Court observed:

> "In our view, Fisher was a joint adventurer with the oil company. As we have seen, *two of the contracts so state.* * * * In the instant case, however, we are not confined to mere terminology in determining that the contracts are of joint adventure. *The entire instruments themselves, as well as the admissions in the briefs tend to establish such relationship.*" (Emphasis ours.)

Under such a state of facts it is obvious why the Court subordinated the claim involved to those of general creditors.

The next most recent case cited and quoted by appellee, *Barks v. Kleyne,* 15 Fed. (2d) 153, 154, C. C. A. 8th, is clearly in support of appellant's position. The Court there viewed any attempt to subordinate one creditor of a class to another of the same class as a forfeiture or penalty, and therefore improper.

> "No provision of the Bankruptcy Act authorizes a penalty and equity abhors forfeitures of clear legal rights."

The remaining case which is in any way related to the instant problem involves a situation where the claimant was a stockholder. After discussing the distinction between stockholders and creditors, the Court in that case, *In re Hicks-Fuller Co.,* 9 Fed. (2d) 492, 494, C. C. A. 8th, said:

> "* * * the conclusion would seem to follow that the claimants are stockholders instead of creditors."

Clearly, there is no question that claims of general creditors are prior to those of stockholders, and therefore the case is irrelevant.

III.

Where There Is a Complete Absence of Evidence on Material Issues It Is the Duty of an Appellate Court to Reject Findings of Fact Based Upon the Presence of Such Evidence.

Appellee has set forth the well-settled rule that an appellate court will not disturb findings of fact of a trial court where there is substantial evidence to support them. Appellant does not question this rule of law, but merely urges that under the very rule stated it is the *duty* of the appellate court to reverse the decision of a trial court where there is no substantial evidence to support findings on which it is based. For authority we need look no further than those cases cited under Point IV of appellee's brief, and a more complete and accurate statement of the law in Remington on Bankruptcy, section 3871.50, as follows:

> "Where there is any substantial evidence to support the lower court's findings of fact in cases where appeal is in matter of law only, the facts will be considered as so established; *but where there is an entire absence of supporting evidence there is error of law.*"

Conclusion.

From the foregoing analysis of facts and authorities it is urged that there is no evidence in the record to justify the penalty imposed upon appellant by the present judgment, and that the only conclusion which the trial court could properly have reached is that sought by appellant.

Respectfully submitted,

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Attorney for Appellant.